The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been working together since 2002 to make International Financial Reporting Standards (IFRS) and U.S. generally accepted accounting principles (U.S. GAAP) compatible. They now are nearing completion on several major projects, including the convergence of revenue recognition standards.

On June 24, 2010, the FASB issued an “exposure draft” of a proposed revenue recognition standard, and plans to approve the final standard by mid-2011. If adopted, the board’s proposed contract-based approach to revenue recognition – designed to ensure economically similar transactions yield similar accounting results – would replace current guidance under U.S. GAAP, including industry-specific revenue standards and interpretations, and align with a concurrently changed IFRS standard. The proposed guidance applies to all customers’ contracts without grandfathering existing contracts, except those including elements such as leases, insurance, debt, equity securities and financial instruments.

In response to these changes, many enterprises will need to adapt certain processes and systems throughout the organization; thus, they should start planning now.

Issue

By developing a common standard that clarifies the principles for recognizing revenue, the FASB and the IASB aim to remove inconsistencies and weaknesses in existing standards and practices and provide a more robust framework for addressing revenue recognition issues. They also look to simplify the preparation of financial statements by reducing the number of standards to which companies must refer, and improve comparability of reported revenue across companies and geographical boundaries.

Current guidance focuses on an “earnings process,” but difficulties often arise in determining when revenue is earned. The FASB and the IASB both believe a more consistent application can be obtained by using a contract-based model, where revenue recognition is based on changes in contract assets and liabilities. Revenue would be recognized as performance obligations are “satisfied” – meaning when control of the asset is transferred to the customer. Timing of revenue recognition may vary depending on whether a contract is for the delivery of a good or for the performance of a service.

The FASB’s and the IASB’s proposed revenue recognition model, if adopted, also would affect current revenue recognition practices related to:

- **Identification of separate performance obligations:** An entity would be required to divide a contract into separate performance obligations for goods or services that are distinct. As a result of those requirements, an entity might separate a contract into units of accounting that differ from those identified in current practice.

- **Licensing and rights to use:** An entity would be required to evaluate whether a license to use the entity’s intellectual property (for less than the property’s economic life) is granted on an exclusive or a nonexclusive basis. If a license is granted on an exclusive basis, an entity would be required to recognize revenue over the term of the license. That pattern of revenue recognition might differ from current practice for certain arrangements.

- **Use of estimates:** Entities would estimate the standalone selling prices of undelivered goods and services and recognize revenue when goods and services are delivered to the customer.

- **Capitalization of costs:** Costs would be capitalized only if they qualify for capitalization in accordance with other standards. As a result, an entity would recognize such costs as expenses as incurred, which may not be the same period in which the related revenue is recognized.

- **Disclosure:** The proposed guidance specifies disclosures to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows.

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arising from contracts with customers. An entity would be required to disclose more information about its contracts with customers than is currently required, including more disaggregated information about recognized revenue and more information about its performance obligations remaining at the end of the reporting period.

Challenges and Opportunities
Revenue recognition under current IFRS and U.S. GAAP guidance has been an accounting challenge requiring complex analysis and data gathering, and the provision of fair value evidence. Companies that have struggled most are those with “multiple element arrangements,” like hardware and software manufacturers that must account for revenue from sources such as product sales, services, licenses, upgrades and devices – all of which may be associated with just one asset purchased by a consumer.

In October 2009, in a move underscoring that convergence of IFRS and U.S. GAAP is on its way, the FASB released two accounting standards that ease the burden on these companies. Accounting Standards Updates (ASU) 2009-13 and 2009-14 address:

- Multiple-deliverable arrangements to enable vendors to account for products and services (deliverables) separately, rather than as a combined unit; and
- Revenue arrangements that contain tangible products and software.

These changes, once adopted, allow for increased use of judgment by management in the determination of revenue to be recognized.

Our Point of View
These new – and proposed – standards related to revenue recognition provide insight into the future of U.S. GAAP and IFRS convergence. The SEC has not yet decided whether to incorporate IFRS into the financial reporting system for U.S. issuers; if it does proceed, the first time U.S. firms would report using IFRS would be no earlier than 2015.

Meanwhile, regardless of the timing of any IFRS conversion, revenue recognition convergence is already under way, and organizations must take steps now to be in a position to make appropriate changes in people, processes and technology. In particular, organizations should examine their processes and systems around data capture and revenue recognition reporting, and make certain data flowing from transaction reporting to financial reporting is accurate. Long-term projects, such as system changes and employee education, will be unavoidable for many firms that must adapt to IFRS and U.S. GAAP convergence, and require early planning to be successful and cost-efficient.

How We Help Companies Succeed
U.S. GAAP and IFRS convergence raises numerous issues for companies. Protiviti can help you assess the impact of these changes on your organization by using diagnostics and other tools to identify and prioritize infrastructure issues that require attention. We can assist with policy and procedure development or modification, accounting and reporting process redesign, IT/ERP system controls updates or improvements, and IFRS-related project management, among other areas, and help you transform people, processes and technology.

In our work assisting clients worldwide with their internal controls, we have developed solutions that help CAEs, CFOs, CIOs and chief legal officers manage change. Our approach is based on the early establishment of a sound foundation with tone-at-the-top support and rigorous project management.

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About Protiviti
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